8/14/12
Global Telecom & Technology
PINK:GTLT
Last: $2.45

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Summary:

- Well-run telecom network integrator with extremely focused management team
- Asset-light business that has grown EBITDA per share by ~40% a year
- 5x run-rate FCF
- Insiders own 44% of the company and have recently bought stock
- Insiders have purchased 12% of the company's shares in the open market
- Currently trades for ~$2.45 but is worth at least $4.00
- Shares can be listed on NASDAQ once stock trades above $3.00

GTLT is a small, well-run company that generates a lot of cash and is building a track record of putting that cash to good use. The story is straightforward and the undervaluation is clear.

GTLT is a global network integrator. It does not own telecommunications infrastructure, but rather buys capacity from a multitude of other carriers and uses this purchased capacity to form its own global network. GTLT sells its network to business and government customers, as well as to other carriers.

The company began life in January of 2005, as a SPAC. In Q4 of 2006 the SPAC finally made its big deal, spending $45 million to acquire Global Internetworking and European Telecom and Technology. These two companies were merged into one to form an intercontinental foundation that GTLT planned to use to create a leading network integrator [also known as a multi-network operator ("MNO") or virtual network operator ("VNO")] through a combination of organic growth and acquisitions.

Expectations coming out of the gate were far too high though and when the company couldn't meet them, the stock crashed and was left for dead. The folks running the company stuck to the game plan, however, and have been resolutely executing on it since then. Eventually the stock began to recover, and earlier this year it made big gains in a very short period of time. The stock remains dramatically undervalued, however.

GTLT is distinct from most other telecom carriers because it owns almost no hard assets, just contracts and relationships. GTLT buys excess capacity from telecom carriers around the world (it has more than 800 suppliers/partners), and then aggregates all of this capacity into one global and largely redundant telecom network. Without somebody like GTLT, customers who would like access to this sort of network have to build it themselves by finding and contracting with each sub-provider directly. In most cases this would be impractical and in some cases it would probably be impossible.

GTLT offers its network to multinational businesses and government organizations, as well as other carriers. Most telecoms could be considered competitors to GTLT, but many of GTLT's customers use multiple telecom carriers, and buy GTLT's offerings as complementary services. GTLT focuses on basic data communication as well as more specialized services such as private lines, colocation, and wide-area networks. The company can provide international organizations with enterprise-wide networks that are secure, scaleable, fast, and act like the LANs most of us have in our homes and offices. Or, if a customer transfers a lot of data between two locations on opposite sides of the world and needs a fast, redundant, secure, and dedicated connection between those two locations, GTLT can probably provide it.

GTLT's network is also attractive to other carriers because it can provide enterprise-grade connectivity across multiple continents, something which can be hard for asset-based carriers to do by themselves. So many carriers buy GTLT's network in order to fill out coverage gaps in their own networks.

GTLT's customer base is fairly diversified, with its five largest customers representing 18% of revenue, and the largest customer being less than 7% of revenue. In total the company has more than 1,000 customers, with 70% of revenue coming from customers based in the U.S., and the remainder coming from Europe. Contracts are typically fixed-price and last 1-3 years. The historical customer churn rate is 2.0-2.5%. 70% of growth has historically come from existing customers.

Since the business is basically a utility, revenues are steady. In 2009 sales were only down 4%, and EBITDA actually increased significantly because of overhead reductions. Over time I think the company's organic growth rate should be equal to GDP plus or minus a few points, but the company believes that organic revenue growth above 10% is possible as a result of new customers (for instance, the company just added a government contract for $3.5 million per year) and the emergence of "cloud" computing. As multinational organizations convert desktop computers to cloud-based systems, the need for network operators who can deliver global services will grow.

The financial mechanics of the business are fairly simple. GTLT prices its business at an approximate 30% gross margin. COGS consists almost entirely of capacity payments to the company's telecom suppliers, so gross margin doesn't budge much regardless of the level of revenue. In contrast, SG&A is almost completely fixed. Prior to nLayer acquisition, GTLT had run at $18M of SG&A (exclusive of D&A) for most of its corporate history. The variable COGS but fixed SG&A make the incremental EBITDA margin on new revenue roughly equal to gross margin: 30%. Considering that GTLT's current EBITDA margin is 12%, operating leverage is more than two to one. That means new revenue is extremely profitable, making GTLT's business ideal for acquisitions.

When GTLT makes an acquisition, it essentially buys the customers and capacity contracts, and leaves the rest. Historically the company has been able to eliminate virtually all of the corporate overhead at the firms it acquires, leaving a pre-tax cash profit roughly equal to the acquired company's gross profit, minus interest from the debt used to finance the acquisition. Finally, GTLT hasn't paid meaningful cash taxes to date, and as a result of the recent nLayer acquisition (discussed below), it has an intangibles amortization tax shield that should protect at least the next few years of profits.

	2007	2008	2009	2010	2011	2012 Pro Forma
Revenue	**57.6**	**67.0**	**64.2**	**81.1**	**91.2**	**115.0**
Cost Of Goods Sold	40.2	47.6	45.9	57.0	64.2	80.5
Gross Profit	**17.4**	**19.4**	**18.4**	**24.1**	**27.0**	**34.5**
SG&A	18.1	18.2	14.7	18.0	18.6	20.5
EBITDA	**(0.7)**	**1.2**	**3.7**	**6.0**	**8.4**	**14.0**
D&A	2.7	2.2	1.7	2.8	3.9	7.3
Operating Income	**(3.4)**	**(1.0)**	**1.9**	**3.2**	**4.5**	**6.7**
Net Interest Exp.	(0.6)	(0.8)	(0.8)	(1.4)	(2.5)	(4.0)
Impairments, FX, Other	(2.5)	(41.9)	(0.6)	(0.4)	(1.2)	0.0
Pre-tax Income	**(6.6)**	**(43.7)**	**0.5**	**1.5**	**0.8**	**2.7**
Income Tax Expense	(2.3)	(1.3)	0.0	0.1	0.6	0.0
Net Income	**(4.3)**	**(42.4)**	**0.5**	**1.4**	**0.3**	**2.7**
GAAP EPS	**($0.37)**	**($2.83)**	**$0.04**	**$0.09**	**$0.02**	**$0.14**
Shares Outstanding, Diluted	13.3	15.0	15.4	17.0	18.7	18.8
Gross Margin	30%	29%	29%	30%	30%	30%
EBITDA Margin	-1%	2%	6%	7%	9%	12%
FCF Margin	-2%	1%	5%	7%	6%	8%
Net Debt	5.5	3.0	7.2	7.7	24.7	38.7
Net Debt/EBITDA	NM	2.5x	2.0x	1.3x	2.9x	2.8x
Cash Earnings:						
EBITDA	(0.7)	1.2	3.7	6.0	8.4	14.0
CapEx	(0.4)	(0.6)	(0.4)	(0.2)	(0.5)	(0.6)
Cash Interest	(0.1)	(0.1)	(0.3)	(0.6)	(2.2)	(4.0)
Cash Taxes	0.0	0.0	0.0	0.0	0.0	
Cash Profit	**(1.1)**	**0.5**	**2.9**	**5.3**	**5.7**	**9.4**
Cash Profit per Share	**($0.09)**	**$0.03**	**$0.19**	**$0.31**	**$0.30**	**$0.50**
@ 37.5% Tax Rate	**$0.03**	**$0.08**	**$0.16**	**$0.27**	**$0.26**	**$0.45**

On April 30 GTLT announced it was paying $18 million ($12 million in cash, $6 million in earn-outs) to acquire nLayer, a private provider of IP transit and Ethernet transport. GTLT financed the deal almost entirely with debt.

nLayer's 2011 revenue and EBITDA were $15 million and $2.6 million respectively. nLayer is growing though, and its EBITDA is already up to a ~$3.5 million run rate based on recently released pro forma Q1 financials as well as the just-released Q2 financials, which include two months of actual contribution from nLayer. This suggests a purchase price multiple of ~5x EBITDA, assuming the earn-out is paid in full.

GTLT and nLayer together are now at an EBITDA run-rate of $14 million or so. EBITDA in the just-released Q2 was $3.2 million, but in Q3 I think it will be $3.5 million or above due to an additional month of contribution from nLayer, as well as growth from the new government contract and other new business. There could also be additional room to grow EBITDA further through duplicate expense reductions.

At $14 million of EBITDA, $4 million of interest expense, negligible CapEx, and just under 20 million shares, GTLT's run-rate FCF per share is about $0.50.

In addition to adding EBITDA, the nLayer deal also brings valuable physical and intangible assets. nLayer invested more than $4 million in the past two years alone outfitting its important datacenter locations with new Juniper equipment, and its CTO Richard Steenbergen is extremely well-regarded within the industry. He has become GTLT's CTO.

GTLT's business is inherently asset-light, as it consists primarily of contracts and relationships. The company owns switching gear at Points-of-Presence around the world, but little else in the way of physical assets. Pro forma for the acquisition of nLayer, GTLT's revenue and EBITDA are approximately $115M and $13.5M, respectively, while PP&E is just $5.6M. Historically CapEx has equaled 60bps of sales, but could creep up a bit in the coming quarters as the company outfits its non-nLayer network with Juniper routers. Further, working capital is negative because customers pay GTLT before GTLT pays its capacity suppliers.

Net debt is currently around 3x pro forma EBITDA, and as the ratio drops due to cash generation I would not be surprised to see the company make another acquisition. There are numerous small private competitors out there, and some of them have trouble competing with GTLT's scale. Some are not profitable as standalone entities and so cannot threaten GTLT from a price perspective. That problem that will only intensify as GTLT gets bigger through further consolidation.

GTLT's CEO, Rick Calder, owns 6% of the company and has recently bought additional shares in the open market. He has an MBA from Harvard and a BS from Yale. He is a skilled operator and very focused on growing GTLT. I think the historical financials provide an excellent example of the company's steady, consistent improvement under his leadership. So far his consolidation of acquisitions has been flawless.

GTLT's Executive Chairman, Brian Thompson, runs a telecom private equity fund that is GTLT's largest investor, owning 27% of the company. I suspect this fund includes most of Mr. Thompson's net worth, but I cannot confirm that. The fund has recently bought shares in the open market. Mr. Thompson has an MBA from Harvard as well and is, for lack of a better term, the strategic visionary.

Insiders have purchased GTLT shares in the open market on a regular basis for most of the company's short history. Since October of 2006, insiders have purchased a total of 2,189,858 shares—12% of the shares outstanding—at an aggregate purchase price of $2.5M. In total, 14 different insiders have made purchases, including directors, executives, and VPs. The attached model includes a tab with a list of these purchases. Insiders have continued purchasing shares even after the stock's recent move. Since the end of March, Brian Thompson has bought stock four times, with his purchases totaling 46,700 shares for $103,133. In early June, Rick Calder bought 10,000 shares for $20,900.

The company has been judicious about equity issuance, preferring to finance acquisitions with debt given the undervaluation of GTLT shares. Once the market awards GTLT a fair multiple, the company will have the option of using equity to speed the pace of acquisitions, if it so chooses.

Why is GTLT so cheap today?

First, GTLT is a $45M market cap on the pink sheets, so few investors know about it. The stock is quite illiquid (especially lately) because of the high insider ownership.

Second, GTLT has completed three acquisitions in the past two years, leaving the financials in a messy state. These acquisitions have all increased the per-share value of the company, but they've also made LTM comparisons mostly useless.

Third, the acquisitions have involved significant purchase price allocations to intangibles, and the attendant amortization charges, which have seriously depressed GAAP profits.

The stock is very cheap. GTLT's run-rate EBITDA is $14 million while its enterprise value is $87 million, putting EV/EBITDA at 6x. Because the company pays no taxes and has very little capex, the FCF multiple is similar; untaxed FCF per share is ~$0.50 and the current stock price is $2.45.

What multiple does GTLT deserve? The business is certainly above-average, but it isn't spectacular. It will survive just fine even in a severe recession, but on the flip side organic growth is probably never going to exceed 2-3x developed world GDP growth, although profits will increase faster than revenues due to overhead leverage. To me an FCF multiple of 10-12x seems reasonable. That would put the stock between $4 and $5.

Share Price	$ 2.45
Fully Diluted Shares	20.5
Market Cap	**50.2**
Debt	43.6
Cash	5.0
Option/warrant proceeds	2.0
Net Debt	**36.7**
Enterprise Value	**86.8**
EBITDA	14.0
CapEx	(0.6)
Cash Interest	(4.0)
FCF w/ NOL	**9.4**
Taxes @ 37.5%	(1.0)
FCF w/o NOL	**8.4**
EV/EBITDA	**6.2x**
Price/FCF w/ NOL	**5.3x**
Price/FCF w/o NOL	**6.0x**

Sharecount Calculation

	Quantity	**Strike Price**	**Proceeds ($M)**
Basic Shares Out	18.8	NA	NA
Warrants	0.6	$ 1.14	0.7
Options	1.1	$ 1.20	1.3
Total	**20.5**	**NA**	**2.0**

Acquisitions create the possibility a higher value. Every acquisition the company has made has resulted in significant growth in the per-share intrinsic value of GTLT. If the company can keep the acquisition train rolling over the next few years, $4.00 to 5.00 could ultimately prove conservative.

If for some reason the acquisition pace slows, the company can use its cash flow to rapidly reduce the debt, which is fairly high-cost at around 10% blended. In the absence of acquisitions, I think the company could be debt free within three years. Profits would increase pretty quickly in this scenario—the elimination of debt would grow pre-tax FCF by 40%.

Catalysts?

First, NASDAQ. Once the shares have consistently traded above $3.00 for a few months, the company should be able to move from the pink sheets to NASDAQ. I think this could result in both multiple expansion and increased trading volume.

Second, a full year with nLayer. Although GTLT's pro forma EBITDA is $14 million, its LTM EBITDA is under $11 million, and since there isn't any analyst coverage, figuring out the run-rate EBITDA takes more work than just looking at Bloomberg.

Third, time. As the quarters pass, the company will generate FCF that it can either use for further acquisitions (grow EBITDA) or debt reduction (grow cash flow). With revaluation and a bit more EBITDA growth, the company will be large enough to begin garnering analyst coverage.